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FM AMEMBASSY TOKYO
TO RUEHSS/OECD POSTS COLLECTIVE PRIORITY
RUEATRS/TREASURY DEPT WASHDC PRIORITY
RUEHC/SECSTATE WASHDC 8442
INFO RUEHFK/AMCONSUL FUKUOKA PRIORITY 0714
RUEHNH/AMCONSUL NAHA PRIORITY 3072
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RUEHKSO/AMCONSUL SAPPORO PRIORITY 1288

UNCLAS TOKYO 003042

SENSITIVE
SIPDIS

TREASURY FOR CARNES, MONROE, MURDEN; STATE EB FOR SAKAUE AND NELSON

E.O. 12958: N/A

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SUBJECT: RESPONSE TO: INFORMATION GATHERING REQUEST: SUMMIT ON FINANCIAL MARKETS AND THE WORLD ECONOMY IN WASHINGTON, NOVEMBER 15, 2008

REF: SECSTATE 114420

Key Objectives and Priorities/ Desired Outcomes of the Summit

¶1. (SBU) Japan's key Summit objective is to matter. PM Aso has to call a general election by September 2009 and would like to leverage leadership in the Summit process to build domestic support at home. Top public officials have regularly gone on record saying that Japan's own financial crisis experience will be valuable to the United States. FM Nakagawa has also proposed to route a portion of Japan's foreign exchange reserves through the IMF. PM Aso called for the G-20 to consider three measures during a press conference October 30: supervision and regulation of international financial firms, the regulation of credit rating agencies, and a review of accounting standards.

Key Concerns

¶2. (SBU) Japan's greatest concern is the outsized impact of the financial crisis on domestic equity markets.

Impact of Financial Market Crisis on the Financial Sector

¶3. (SBU) Japanese equity markets have declined to the point that banks must recognize unrealized market losses on their equity holdings. This detracts from Tier 1 capital, leading the banks to seek to raise additional capital. Japan's financial firms have otherwise been relatively insulated. Nomura Holdings took over Lehman's Asian, European, and Middle Eastern operations, while MUFG took a 21% stake in Morgan Stanley.

Actions Taken to Address the Financial Crisis

¶4. (SBU) The Japanese government has undertaken a number of measures, including: a review of capital adequacy calculation methodology for strictly domestic financial institutions; mark-to-market accounting reforms in measurement and classification (apparently consistent with Europe and the U.S.); possible public funds bank capital injection, increased from Y2 trillion to Y10 trillion (\$100 billion) under a revived bank recapitalization law; ban on naked short selling; investigation of possible violations of short selling rules; and measure to allow banks to hold equities beyond Tier 1 capital. To encourage stock investment, the government has proposed resumption of equity

purchases by the government-backed Banks' Shareholdings Purchase Corporation, and has extended preferential tax treatment on capital gains and dividend income.

Current Economic Situation/Near-Term Outlook

15. (SBU) Japan's real GDP contracted at 3.0 percent seasonally adjusted annual rate in the second quarter. Both the Bank of Japan and the Cabinet Office have downgraded their growth assessments, and most analysts believe Japan is already in recession. Though core CPI rose 2.4% y/y in August, there is speculation that the BOJ will cut its target rate from 0.5% to 0.25%. Japan's current account surplus declined 53% y/y in August, shrinking for the sixth straight month due to weak exports and high energy import costs. The yen has also appreciated substantially against both the dollar and the euro in recent weeks.

SCHIEFFER